

Statement of
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Before the
Subcommittee on Aviation
of the
Committee on Transportation and Infrastructure
U.S. House of Representatives

July 26, 2001

Mr. Chairman and Members of the Subcommittee:

I am Director for Aerospace and Automotive Trade Policy within the Office of the United States Trade Representative (USTR).

No sector is more illustrative of the importance of international trade to the United States than the American aircraft manufacturing industry with the majority of its sales being exports to foreign-owned airlines. The economic health of the domestic airline and air carrier industry is also of significant importance to the U.S. manufacturers of aircraft, engines and their suppliers, as well as to the workers in both these and related industries.

The Administration clearly recognizes the vital importance of our aircraft and aerospace industries, both civilian and military, to U.S. economic growth, national security and international trade performance. By any measure, we are the world's leader in the production and export of aerospace products. Total aerospace shipments in the year 2000, of both military and civilian products, were \$137 billion -- and 39 percent or \$53 billion of this was exported. Imports were approximately \$28 billion -- resulting in a positive trade balance contribution for this industry of \$25 billion. This makes this industry the leader in U.S. net manufactured goods exporting.

Breaking out from this total just civil aircraft products, including engines, avionics and parts, the United States exported approximately \$45 billion in the year 2000 and imported \$25 billion -- resulting in a net positive trade balance of \$20 billion in this sector. One large commercial user of civil aircraft, the air carrier industry, is directly responsible for over \$30 billion in current account service "export" sales and indirectly accounts for current account revenues in other sectors, such as tourism, and business services. For the United States, the continued well-being of the American aircraft and the air carrier industries is crucial to the country's economy and obviously critical to our international trade performance.

I appreciate the opportunity your Subcommittee has afforded to discuss the competitiveness of the U.S. aircraft manufacturing industry from the perspective of the President's Trade Agreements Program. I will first provide a brief overview of major trade agreements governing civil aircraft trade -- including the *Marrakesh Agreements establishing the World Trade Organization*, the *WTO Agreement on Trade in Civil Aircraft*, and the 1992 U.S.-European Community *Agreement Concerning the Application of the GATT Agreement on Trade in Civil Aircraft to Large Civil Aircraft*. I will also relate how those disciplines affect the competitive environment for international trade in aircraft, describe the status of some current trade problems facing the industry, and the Administration's efforts to respond to them.

Summary of Major International Agreements Governing Aircraft Trade

The importance of the U.S. aircraft industry has been recognized in the negotiation of international trade agreements and in special provisions and agreements dealing with aircraft trade. One purpose of the Trade Promotion Authority that the President seeks, is to improve and expand the WTO Aircraft Agreement, as well as to conclude other WTO and plurilateral agreements that would reduce tariff and non-tariff barriers to all U.S. exports including aircraft.

The Marrakesh Agreements establishing the World Trade Organization, entered into force in 1995, and they are the only broad multilateral instruments which lay down agreed rules for international trade in goods as well as for aircraft.

- Current Signatories comprise 141 countries that account for more than 85 percent of world trade.
- A major provision that affects aircraft trade is the schedule of bound tariff concessions. Under the WTO, the United States currently accords duty free treatment to imports of civil aircraft, engines, and most components and parts from other WTO Members and other nations to which we extend "Normal Trading Relations".
- In addition, GATT 1994 and the accompanying plurilateral agreements, contain the international rules with respect to non-tariff trade barriers. For example, the WTO requires national non-discriminatory treatment on internal taxes and regulations with respect to imported products, prohibits most quantitative restrictions and export subsidies on manufactured goods, creates clear rights of action against dumping and domestic subsidies that cause adverse affects; and provides binding procedures for resolving disputes that arise among WTO Members.

The Agreement on Trade in Civil Aircraft (Aircraft Agreement) was originally concluded in 1979 as part of the "Tokyo Round" of multilateral trade negotiations as a unique sector-specific trade agreement intended to expand trade by removing tariff and reducing non-tariff barriers.

The Aircraft Agreement requires Signatories to eliminate duties on civil aircraft, their engines, subassemblies and parts, and to provide these benefits to all WTO Members. On non-tariff issues, the Aircraft Agreement establishes international obligations concerning government intervention in aircraft and aircraft component development, manufacture and marketing, including:

- Government-directed procurement actions and mandatory subcontracts: The Agreement provides that purchasers of civil aircraft (including parts, subassemblies, and engines) will be free to select suppliers on the basis of commercial considerations and governments will not require purchases from a particular source (i.e., no government mandated offsets).
- Sales-related inducements: The Agreement states that governments are to avoid attaching political or economic inducements (positive or negative linkages to government actions) as an incentive to the sale or lease of civil aircraft.
- Certification requirements: The Agreement provides that civil aircraft certification requirements and specifications on operating and maintenance procedures will be non-discriminatory as provided by the provisions of the separate Agreement on Technical Barriers to Trade.
- With respect to government support, the Aircraft Agreement was not updated during the last round of negotiations, so it does not reference the 1994 WTO Agreement on Subsidies and

Countervailing Measures; however it declares that in providing such support, Signatories shall seek to avoid adverse effects on other Signatories and that the pricing of civil aircraft should be based on a reasonable expectation of the recoupment of all costs including the repayment of government loans.

There are 27 Signatories to the Agreement: Bulgaria, Canada, the European Communities, Austria, Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, the United Kingdom, Egypt, Georgia, Latvia, Malta, Japan, Macau, Norway, Romania, Switzerland and the United States. Albania, Croatia, Chinese Taipei, Estonia and Lithuania have indicated that they will become parties upon accession to the WTO and Oman within three years of accession.

In 1996, Russia bilaterally agreed with the United States to eventually become signatory to the WTO Aircraft Agreement and in the interim to allow reasonable access to its domestic market for foreign civil aircraft by waiving the high Russian import duties. We are seeking Russia's accession to the Aircraft Agreement as part of Russia's general accession process to the WTO. China did not accept the Aircraft Agreement, but has agreed to accept similar obligations as part of China's WTO accession, including duty-free or low-duty treatment on aircraft products.

While the Aircraft Agreement was not renegotiated during the Uruguay Round, it remains fully in force and is included in the WTO as a plurilateral agreement with binding obligations for those countries that are signatories to it.

The Annex to the Aircraft Agreement contains the list of aircraft products to be accorded duty free treatment. The Aircraft Committee, made up of the signatories to the Agreement, has recently decided on changes to be made to the Annex in order to implement revisions to the Harmonized System of tariff nomenclature. The Aircraft Committee is expected to shortly agree to open a formal protocol to the Aircraft Agreement for Signatory ratification in order to implement those revisions. However, with respect to expanding coverage to new aircraft items (a number of which have been developed due to changes in technology), the Administration lacks the authority to implement duty free treatment for those new aircraft products until Trade Promotion Authority legislation is passed. This is another indication of how important it is for Congress to restore the President's tariff cutting authority – which Congress has granted Presidents for 30 years.

Although changing market conditions and foreign government practices make it difficult to interpret the net effects upon competitiveness of the WTO Aircraft Agreement, it has contributed to the reduction of trade barriers among the signatories in sales into their own markets and in their competition to sell in third markets. Broad international markets are essential for achieving scale efficiencies in aircraft and engine programs where a positive return on investment in any one program is a long term and uncertain prospect. Tariff eliminations have also reduced costs for aircraft manufacturers on imported components or subassemblies, as well as maintained the continued access of U.S. suppliers to markets where a tariff barrier might have effectively prohibited competition with domestic suppliers.

Nonetheless, the Agreement has not been entirely effective in moving toward the attainment of all its objectives. Specifically, the Aircraft Agreement did not appear to deal effectively with massive government subsidies provided the Airbus Consortium. Although in 1991 a successful complaint was brought under the GATT Subsidies code against German export exchange rate subsidies for Airbus and a broader complaint against all Airbus subsidies was initiated, the solution sought by both sides was a negotiated one.

The resulting 1992 U.S.-European Community Agreement Concerning the Application of the GATT Agreement on Trade in Civil Aircraft to Large Civil Aircraft covers large civil transport aircraft

(100 or more seats).

This agreement contained specific disciplines over European government support for the Airbus Consortium. The provisions include: (1) a prohibition on government support for production; (2) a limit on the proportion of government support for development of any new aircraft at 33 percent of total development cost with a repayment schedule at interest rates above the government cost of funds (this compares with the government share of development costs averaging from 75 to 100 percent on the previous Airbus programs and extremely low rates of interest for government loans); (3) no revisions to the terms and conditions of previously-committed government support that would make it more favorable to the recipient; (4) clarification of disciplines against unreasonable government intervention in aircraft marketing or procurement decisions; and (5) increased transparency of both direct and indirect government support activities.

Significant efforts were made to conclude a revised Aircraft Agreement as part of the “Uruguay Round” negotiations that would have included greater disciplines on supports similar to those contained in the U.S.-EU bilateral aircraft agreement. However, in the late stages of those negotiations, the EU, in fact, sought to weaken disciplines on subsidies in the aircraft sector by removing aircraft entirely from the coverage of the proposed WTO Agreement on Subsidies and Countervailing Measures.

Although revisions to the plurilateral Aircraft Agreement could not be agreed by the conclusion of those negotiations, subsidies to aircraft were made subject to the improved disciplines of the WTO Agreement on Subsidies, an outcome strongly endorsed by the U.S. aerospace industry. Because of continuing differences between the U.S. and EU, the Aircraft Agreement has not been updated to correctly reference and conform to the new WTO structure (including the WTO dispute settlement mechanism).

The Current Situation

From 1992 until 1997, the EU Airbus governments did not provide any new direct supports for the development of new Airbus aircraft programs. However, in the following two years, they announced new government support for the development of derivative versions of the existing Airbus A330 and A340 aircraft.

In April 2001, the EU notified the U.S. that seven Member States had made commitments to provide development support for the Airbus A380 (super-jumbo) aircraft. They also provided information under the transparency provisions of the 1992 Agreement on the terms of that support and publicly declared that it was on terms consistent with the interest rate and repayment terms of the 1992 bilateral Large Aircraft Agreement and within the 33 percent limit for such support.

Although we appreciated this notification, the Administration continues to be concerned about further EU Member State subsidies for Airbus since it is a mature company with about half of the global aircraft market; and Ambassador Zoellick has raised this with EU Trade Commissioner Pascal Lamy. Under the 1992 bilateral Agreement, funds can be provided by a government only after a critical project appraisal, based on conservative assumptions, confirms that there is a reasonable expectation that the project is commercially viable and will repay its investors. We have reviewed the information in the EU’s April notification on supports for the A380. However, in order to undertake a meaningful analysis, we have requested supplemental information from the EU prior to our next consultations.

Other Trade-Related Matters

During WTO Aircraft Committee meetings and bilaterally, we have also pursued other possible trade distortions that might affect the competitive situation of U.S. aircraft manufacturers and air carriers.

These include foreign government support for aircraft suppliers, delays in certification of large U.S. aircraft and business jets, and EU regulation of aircraft equipped with noise quieting hushkits and engines. On this last matter, the Administration initiated an arbitration dispute resolution procedure in the International Civil Aviation Organization (ICAO) under Article 84 of the Chicago Convention last year, and we are actively discussing the resolution of this matter with the EU in the context of the development of new ICAO standards for aircraft operations.

The Administration has also intervened as a third party in the aircraft subsidy dispute in the WTO between Brazil and Canada. Though the U.S. does not currently produce the size aircraft involved in the dispute, we believe that the interests of U.S. aircraft and component producers are best served by minimizing the use of trade distorting subsidies by Canada and Brazil. We, therefore, continue to focus our attention on ensuring that the WTO Agreement on Subsidies and Countervailing Measures is interpreted in a way that will strictly discipline the use of export subsidies.

The Administration is also concerned about the adverse effects of free trade agreements that have been negotiated by other countries, for example, the association agreements between the EU and several Eastern European countries, which provide tariff preferences for EU exports of aircraft and other products. While we are seeking and have achieved some unilateral tariff suspensions for aircraft exports to these countries, U.S. aircraft exporters could lose business to foreign competitors in Eastern Europe or in other countries with similar preferential trade agreements. There are over 130 preferential trade agreements in the world today, and the U.S. is a party to only two. Trade Promotion Authority is needed to place U.S. aircraft exporters on an equal footing in world markets.

Next Steps

In the future, the Administration will continue to seek to update and strengthen the WTO Aircraft Agreement by bringing it further into conformity with the new WTO framework, while maintaining the balance of rights and obligations with respect to the other WTO agreements.

The Administration will also continue to make it a high priority for countries with aircraft industries that are seeking membership in the WTO to become a Signatories to the Agreement on Trade in Civil Aircraft as part of their WTO accession obligations. Other countries that procure civil aircraft products, but are not currently significant aircraft product manufacturers, are also being encouraged to become Signatories to the WTO Aircraft Agreement in order to foster non-discriminatory and efficient selection processes for aircraft products based solely upon the competitiveness (product quality, price, and delivery) of the supplier.

Finally, the Administration is committed to the appropriate exercise of our rights under multilateral, plurilateral, and bilateral trade agreements covering the aircraft sector. Foreign aircraft competitors should face the same market risks as the U.S. industry and should not be insulated from those risks by various government supports.

Lower tariffs and improved trade rules will benefit the U.S. aircraft industry by removing trade barriers, promoting fair competition, and helping them to export. In order to negotiate new or improved trade agreements and to seek tariff elimination, we hope that the Congress will soon provide the President with the Trade Promotion Authority necessary to do this.